INVESTMENT UPDATE NEWSLETTER
ALLEN TRUST COMPANY
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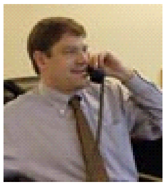

William A. Harris, CFA
Portfolio Manager

The Fed Serves Up Lower Rates, but No Free Lunch

Last month, the Federal Reserve cut both the Fed Funds rate (the target rate for inter-bank lending) and the discount rate (the rate banks pay to borrow at the Fed's window) by 0.50%. Although the cut itself was commonly anticipated, an especial excitement attended its magnitude.

US investors heaved a relieved sigh that the domestic economy may have been hauled back from the brink of recession and cheered a new savior in Ben Bernanke, as if taking comfort that an all-knowing central power will, as under Greenspan, lay on hands to heal fissures in the financial system, mending symptoms if not their causes. Damn the moral hazard, full speed ahead.

Moral hazard (the notion that alleviating the consequences of risky behavior encourages redoubled risk-taking) is a longer-term concept than most people and institutions can process when they're gripped by fear; rather, they resort to foxhole prayer: "Whatever you do, Ben, just make sure I don't die today!" I discussed moral hazard last month. Briefly now, I want to touch on some closer consequences of the rate cut.

The immediate effects are good ones, namely confidence in our financial system, and confidence that cuts belay the economy against recession. This makes for a peculiarly *domestic* comfort, as seen in the stock market's rally, but it comes at a price, plain to see in the US dollar's quick deterioration to record lows, and in rising oil and gold prices. Lower US interest rates make the Greenback less attractive to foreigners; as Greenback value erodes, Americans will lose purchasing power, through rising prices on imports and dollar-denominated commodities alike. In many ways, life just got more expensive. True enough, there will be a silver lining: our export industries will gain competitively. But this remains a peripheral benefit, because ours is not an export-based economy!

We may see that Fed cuts hereforth will force us to turn in on ourselves. Whereas for most of this decade America has hitched onto the rest of the world's economic and financial growth, that ride may now get prohibitively expensive. We've come to expect a nearly free lunch of foreign-financed trade deficits and domestic credit expansion; but our continued prosperity will depend on our domestic abilities to generate real, fundamental wealth, as opposed to achieving its simulacrum via financial engineering or further borrowing.

If so, we're down to a two-legged stool: growth in jobs and in productivity. Strong employment and productivity can be enough for us to balance on, however unstably. If either breaks, look out.

William A. Harris, CFA

Firm News: Big Goings On!

As mentioned before, we've been reconfiguring our offices to accommodate our growth. Now we're happy to announce that September heralded another two important transitions for us.

First, **Sharon Heth, JD**, our VP of Charitable Services, is taking on **an expanded role** in serving client relationships. Her talents and expertise reach beyond the non-profit world, and it's great that she'll have a chance now to exercise them across a broader range of responsibility.

Second, we started **a new relationship to enhance our services and operational efficiency**, working with a firm in Boulder, Colorado now to implement Allen Trust's back office functions. This change will be largely invisible to you (our team is the same, our great service to you will be uninterrupted, and your account numbers and online access here will remain the same), but you may notice a few differences (the format and appearance of account statements, for instance). If anything unfamiliar piques your curiosity, please give us a call! Altogether, this is change that we are already finding better enables us to focus on what we're best at: serving your needs, and the needs of those you love.